54 pg

0266

No. 06-43

FILED
JUN 1 ? 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,

Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. and MOTOROLA, INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF FOR PETITIONER

STANLEY M. GROSSMAN
Counsel of Record
MARC I. GROSS
JOSHUA B. SILVERMAN
POMERANTZ HAUDEK BLOCK
GROSSMAN & GROSS LLP
100 Park Avenue
26th Floor
New York, NY 10017
(212) 661-1100

Attorneys for Petitioner

209092

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

QUESTION PRESENTED

Whether this Court's decision in *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), forecloses claims under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5(a) and (c), 17 C.F.R. § 240.10b-5(a) and (c), where Respondents engaged in their own deceptive conduct in transactions with a public corporation for the purpose and effect of creating a false appearance of material fact that enabled the publication of artificially inflated financial statements by the public corporation, but where Respondents themselves made no public statements concerning those transactions.

STATEMENT PURSUANT TO RULE 26.9

Petitioner's corporate disclosure statement was set forth on page ii of its Petition for a Writ of Certiorari. There are no amendments to that statement.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
STATEMENT PURSUANT TO RULE 26.9	ii
TABLE OF CONTENTS	iii
TABLE OF CITED AUTHORITIES	v
OPINIONS BELOW	1
JURISDICTION	1
STATUTE AND REGULATION INVOLVED	1
STATEMENT OF THE CASE	2
Facts	4
SUMMARY OF ARGUMENT	12
ARGUMENT	17
I. Schemes To Defraud Are Prohibited by the Plain Language of Section 10(b) and Rule 10b-5.	17
A. Deceptive Devices and Contrivances Prohibited by the Plain Text of Section 10(b) Include Schemes to Defraud.	18
B. The Plain and Unambiguous Language of Rule 10b-5 Prohibits Schemes to Defraud.	23

Contents

Page

II. The Court of Appeals Misread *Central Bank* and Ignored This Court's Subsequent Explanation. 26

III. This Court Has Consistently Recognized That Schemes to Defraud Are Unlawful Under the Text of Section 10(b) and Rule 10b-5. 29

IV. Giving Natural Meaning to the Language of Section 10(b) and Rule 10b-5 Would Not Affect Legitimate Business. 32

V. Undermining the Plain Language of Section 10(b) and Rule 10b-5 Would Harm Markets and Create a Blueprint for Fraud. 34

VI. Respondents' Deceptive Conduct Was a Primary Violation of Section 10(b) and Rules 10b-5(a) and (c). 36

A. Petitioner Has Alleged Deceptive Conduct and Scienter by Respondents Themselves. 36

B. Investors' Losses Were Causally Connected to the Scheme – Reliance Is Established. 37

C. Petitioner Should Have Been Granted Leave To Replead. 41

CONCLUSION 42

TABLE OF CITED AUTHORITIES

CASES *Page*

Affiliated Ute Citizens v. United States,
406 U.S. 128 (1972) 19, 29, 30

Basic Inc. v. Levinson,
485 U.S. 224 (1988) 24, 35, 37

Bateman Eichler, Hill Richards, Inc. v. Berner,
472 U.S. 299 (1985) 35

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975) 18, 23

Central Bank, N.A. v. First Interstate Bank, N.A.,
511 U.S. 164 (1994) ..... *passim*

Desert Palace, Inc. v. Costa,
539 U.S. 90 (2003) 18

Dole Food Co. v. Patrickson,
538 U.S. 468 (2003) 21, 22

Ernst & Ernst v. Hochfelder,
425 U.S. 185 (1976) 17, 18, 20, 29

First Interstate Bank, N.A. v. Pring,
969 F.2d 891 (10th Cir. 1992), *rev'd on other grounds sub nom. Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994) 28

In re Global Crossing, Ltd. Sec. Litig.,
322 F. Supp. 2d 319 (S.D.N.Y. 2004) 30

Cited Authorities

Page

Herman & MacLean v. Huddleston,
459 U.S. 375 (1983) 14, 18, 23, 29, 30

Jones v. Bock,
127 S. Ct. 910 (2007) 18, 23, 32

Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,
501 U.S. 350 (1991) 23, 35

Lentell v. Merrill Lynch & Co.,
396 F.3d 161 (2d Cir.),
cert. denied, 546 U.S. 935 (2005) 39

In re Lernout & Hauspie Sec. Litig.,
236 F. Supp. 2d 161 (D. Mass. 2003) 39

Merrill Lynch, Pierce, Fenner & Smith v. Dabit,
126 S. Ct. 1503 (2006) 17, 21, 22

Palsgraf v. Long Island R.R. Co.,
162 N.E. 99 (N.Y. 1928) 39

Papsan v. Allain,
478 U.S. 265 (1986) 8

In re Parmalat Sec. Litig.,
376 F. Supp. 2d 472 (S.D.N.Y. 2005) 21, 33, 39

Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 292 F.3d 1334 (11th Cir.),
cert. denied, 573 U.S. 950 (2002) 23-24

Cited Authorities

Page

Santa Fe Indus., Inc. v. Green,
430 U.S. 462 (1977) 30

SEC v. Zandford,
535 U.S. 813 (2002) 17, 22, 23, 29, 31

Simpson v. AOL Time Warner Inc.,
452 F.3d 1040 (9th Cir. 2006), *petition for cert. filed sub nom. Calif. St. Teachers Ret. Sys. v. Homestore.com, Inc.*, 75 U.S.L.W. 3236 (U.S. Oct. 19, 2006) (No. 06-560) 33, 38, 39, 40

Superintendent of Ins. v. Bankers Life & Cas. Co.,
404 U.S. 6 (1971) 3, 19, 29, 30

United States v. Arthur Young & Co.,
465 U.S. 805 (1984) 35

United States v. Baxter Int'l, Inc.,
345 F.3d 866 (11th Cir. 2003) 41

United States v. Naftalin,
441 U.S. 768 (1979) 25

United States v. O'Hagan,
521 U.S. 642 (1997) 17, 22, 24, 27, 31

United States v. Ron Pair Enters., Inc.,
489 U.S. 235 (1989) 19

Page

Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc., 532 U.S. 588 (2001) 30-31

Williams v. Taylor, 529 U.S. 420 (2000) 21

STATUTES and RULES

Securities Act of 1933, 15 U.S.C. § 77a, *et seq.*

Section 10, 15 U.S.C. § 77j 19

Section 11, 15 U.S.C. § 77k 13, 19

Section 12, 15 U.S.C. § 77l 13, 19

Section 17, 15 U.S.C. § 77q 19

Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq.* .....

Section 10(b), 15 U.S.C. § 78j(b) ..... *passim*

Section 14(e), 15 U.S.C. § 78n 19

15 U.S.C. § 78u-4 ..... 22, 34

15 U.S.C. § 78u-4(b)(2) 33

15 U.S.C. § 78u-4(b)(3) 33

15 U.S.C. § 78u-4(f)(10) 16, 21

15 U.S.C. § 78bb(f)(5)(E) 16, 21

Cited Authorities

Page

18 U.S.C. § 1341 32

18 U.S.C. § 1343 32

Private Securities Litigation Reform Act of 1995, Pub. L. 104-69, 109 Stat. 737 (Dec. 22, 1995) . *passim*

Securities Litigation Uniform Standards Act of 1998, Pub. L. 105-353, 112 Stat. 3227 (Nov. 3, 1998) ... 16, 21

Pub. L. 106-554, 114 Stat. 2763 (Dec. 21, 2000) ... 25

SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 ..... *passim*

SEC MATERIALS

Amicus Curiae Brief of the SEC filed Oct. 22, 2004 in *Simpson v. AOL Time Warner, Inc. (Calif. St. Teachers Ret. Sys. v. Homestore.com, Inc.)*, No. 04-55665 (9th Cir.) 24, 39, 40

In re Charter Communications, Inc., SEC Exchange Act Release No. 50,098 (July 27, 2004) 4, 11

In re Eidson, SEC Exchange Act Release No. 54,031 (June 22, 2006) 11, 37

In re Haislip, SEC Exchange Act Release No. 54,030 (June 22, 2006) 11, 37

Cited Authorities

Page

In re Motorola, Inc., SEC Exchange Act Release No. 55,725 (May 8, 2007) 11, 37

United States v. Barford, et al., SEC Litig. Release No. 19,240 (May 26, 2005) 8, 10, 37

OTHER AUTHORITIES

Black's Law Dictionary (3d ed. 1933) 21

Conference Report on Securities Litigation Reform, H.R. Rep. No. 104-369, 1995 U.S.C.C.A.N. 730 (Nov. 28, 1995) 34-35

Craig Doidge, G. Andrew Karolyi, and Rene M. Stulz, *Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time*, (Apr. 2007) (*available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=982193) 34

Jill E. Fisch, *The Scope of Private Securities Litigation: In Search of Liablility Standards for Secondary Defendants*, 99 COLUM. L. REV. 1293 (June 1999) 22

Charles D. Niemeier, *American Competitiveness in International Capital Markets* (Public Company Accounting Oversight Board, Sept. 30, 2006) (*available at* http://www.pcaobus.org/News_and_Events/Events/2006/ Speech/09-30_Niemeier.aspx) 34

Cited Authorities

Page

Reply Brief of the United States filed April 9, 1997 in *United States v. O'Hagan*, 521 U.S. 642 (1997) 24

Webster's International Dictionary (2d ed. 1934) ... 19-20

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit (Pet. App. 1a-11a) is reported at 443 F.3d 987 (8th Cir. 2006). The orders of the district court dismissing claims against Respondents (Pet. App. 30a-71a) and denying reconsideration and leave to amend (Pet. App. 15a-29a) are unreported.

JURISDICTION

The opinion and order of the Court of Appeals was entered on April 11, 2006. A petition for a writ of certiorari was filed on July 7, 2006. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTE AND REGULATION INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), states as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * *
>
> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5, states as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

Petitioner appeals from a decision of the Eighth Circuit Court of Appeals affirming the dismissal of Respondents from this putative class action brought on behalf of investors in the securities of Charter Communications, Inc. ("Charter") for violations of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (the "Exchange Act") and Rule 10b-5, 17 C.F.R. § 240.10b-5.

Petitioner contends that Respondents Scientific-Atlanta, Inc. ("Scientific-Atlanta") and Motorola, Inc. ("Motorola") (collectively, "Respondents") are primary violators of § 10(b) of the Exchange Act and Rule 10b-5(a) and (c) for their own deceptive acts in a scheme designed to inflate Charter's reported financial performance. Respondents' fraudulent conduct was as straightforward as it was blatant.

In 2000, Charter was facing a shortfall in anticipated revenue and cash flow relative to Wall Street expectations. To close this gap, Charter agreed to overpay Respondents by a total of $17 million for set-top boxes that it had already agreed to purchase from them at lower prices, if Respondents would use those additional funds to "purchase" unwanted advertising from Charter. To create a false appearance that these transactions were legitimate, Respondents: (i) issued documentation falsely stating that Respondents demanded the price increases because of higher costs; (ii) falsely backdated contracts; and (iii) agreed to "purchase" advertising at four to five times regular rates using Charter's funds.

These phony transactions had no business purpose whatsoever. Their only purpose was to artificially inflate Charter's reported revenues and cash flow, and consequently the price of its stock.

Respondents' scheme was the subject of criminal proceedings by the United States Department of Justice ("DOJ"), as well as civil proceedings by the Securities and Exchange Commission ("SEC").

Section 10(b) prohibits the use, "directly or indirectly," of "any manipulative or deceptive device or contrivance in contravention" of SEC rules promulgated pursuant to the section. The issue on appeal is whether Respondents' conduct constitutes a "deceptive device or contrivance" violating SEC Rule 10b-5(a) prohibiting employment of "any device, scheme or artifice to defraud" and (c) making it unlawful to "engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person."

This Court has said that Congress crafted § 10(b) as a catchall provision to prohibit all fraudulent conduct in connection with the purchase or sale of securities, no matter how novel or unique. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 11 n.7 (1971). The scheme alleged here,

however, is little more than a garden variety fraud and falls squarely within the prohibitions of the plain language of § 10(b) and Rule 10b-5.

Flagrant frauds such as the scheme perpetrated by Respondents led Congress to draft the federal securities laws following the stock market crash of 1929. Congress enacted this comprehensive set of statutes to promote investor confidence in our securities markets, which is essential to capital formation and our country's economy.

Facts[1]

Charter is a cable operator that provides video, data, interactive and private business network services to millions of customers across the country through its broadband network of coaxial and fiber-optic cable. J.A. 23a, SAC ¶ 25; Respt. App. 7-8, AC ¶ 22. During the class period it had almost 300 million shares of common stock outstanding which traded on the Nasdaq National Market. *Id.*

Defendants in addition to Respondents were Charter, certain of its executives and Charter's independent auditors. J.A. 23a-26a, SAC ¶¶ 25-36, 39; Respt. App. 7-10, AC ¶¶ 22-33, 36. The claims against all defendants other than Respondents were settled for $146.5 million prior to the district court's ruling on Respondents' motion to dismiss the Amended Complaint. *In re Charter Communications, Inc. Sec. Litig.*, No 4:02-CV-1186, 2005 U.S. Dist. LEXIS 14772, at *30 (E.D. Mo. June 30, 2005).

Respondents at relevant times were public corporations familiar with financial reporting principles and cable industry accounting conventions. J.A. 55a, SAC ¶¶ 98-99. They were

---

1. Paragraph references are to the Amended Complaint ("AC"), printed as an appendix to Respondent Scientific-Atlanta's Opposition to Petition for Writ of Certiorari, and to the Second Amended Complaint ("SAC"), printed in the Joint Appendix.

each major manufacturers of electronic equipment, including digital set-top boxes for the cable industry. J.A. 26a, SAC ¶¶ 37-38; Respt. App. 10, AC ¶¶ 34-35. A digital set-top box is equipment that is placed on a subscriber's television enabling it to receive and view digital television signals. *Id.* Charter purchased set-top boxes from Respondents and supplied them to customers of its cable services. *Id.*

During the late 1990s, cable companies incurred substantial expenses installing cable networks, and it was not unusual for expenses to exceed revenues. J.A. 30a-31a, SAC ¶ 50; Respt. App. 11, AC ¶ 40. Consequently, stock market analysts valued cable companies based upon whether they were achieving significant growth in revenues, indicating increasing market share, and cash flow, rather than more traditional earnings measures. *Id.*

Charter announced its operating results and projections on a quarterly basis in press releases and during conference calls with analysts. *See, e.g.*, J.A. 78a-79a, SAC ¶¶ 146, 147; Respt. App. 49-50, AC ¶¶ 114, 115. Charter management viewed meeting analysts' expectations as critical to maintaining its stock price. J.A. 52a, SAC ¶ 91; Respt. App. 32, AC ¶ 76.

The pleadings allege various fraudulent practices engaged in by Charter during the class period to present a false picture of financial growth and success. J.A. 35a-53a, SAC ¶¶ 58-126; Respt. App. 15-38, AC ¶¶ 48-94. With respect to Respondents, the relevant time frame is the latter part of 2000. J.A. 52a-61a, SAC ¶¶ 90-114; Respt. App. 31-34, AC ¶¶ 75-82.

In August 2000, Charter recognized that it would not meet Wall Street analysts' revenue and operating cash flow projections. J.A. 52a, SAC ¶ 91; Respt. App. 32, AC ¶ 76. A shortfall would devastate the price of Charter's common stock. J.A. 102a, SAC ¶ 195; Respt. App. 69-70, AC ¶ 163. To avoid that outcome, Charter approached each of the Respondents and requested that it purchase advertising on Charter's cable

networks. J.A. 52a-53a, SAC ¶ 92. Respondents had never purchased advertising from Charter before, and they declined to do so with their own money. *Id.*

Charter then devised a scheme to give Respondents the money to "purchase" advertising from Charter. J.A. 54a, SAC ¶ 97. Critically, the scheme could not be accomplished without the active involvement of Respondents and their own deceptive acts. J.A. 55a-58a, SAC ¶¶ 100, 102, 104.

Pursuant to the scheme, Charter would *overpay* each Respondent $20 for each set-top box that it purchased, so long as Respondents used those funds to buy advertising from Charter. J.A. 54a, SAC ¶ 97. These agreements had no legitimate business purpose. J.A. 53a, SAC ¶ 93; Respt. App. 32, AC ¶ 77. At the time, Charter already had in place long-term contracts with Respondent Scientific-Atlanta to purchase set-top boxes at lower fixed prices covering its needs into 2002. J.A. 53a-54a, SAC ¶¶ 94-95. Despite these contracts, however, Charter agreed to pay Scientific-Atlanta $20 additional for each set-top box not only for future purchases, but on all pre-existing unfilled orders for purchases through the end of 2000. J.A. 54a, SAC ¶ 97.

In order to get these transactions past Charter's auditors and reflected in the financial statements Charter would issue to the public, Charter and Scientific-Atlanta agreed to fabricate a justification for the price increase. J.A. 55a-56a, SAC ¶ 100. A Charter executive requested that Scientific-Atlanta send it a false "pricing increase notification letter" stating:

> 1. The reason for the price increase and the date (09/01/00) of the increase.
>
> 2. A description of the quantities of set-tops this letter cover (the anticipated number of set-tops (351,180) that S-A expects to ship and Charter expects to take delivery of between 09/01/00 and 12/31/00[)].

3. A penalty provision in case Charter doesn't accept the anticipated number of set-tops in the specified time frame.

J.A. 55a-56a, SAC ¶ 100.

The sham "advertising" was discussed in this same communication, confirming that it was related to and intertwined with the set-top box price increases. *Id.* (stating "I will be sending the advertising contract for review prior to the particulars being worked out.").

As a willing partner in the scheme, Scientific-Atlanta submitted documentation to Charter falsely attributing the price change to "increased manufacturing" costs. J.A. 57a, SAC ¶ 102.

Charter similarly agreed to pay Motorola inflated prices for set-top boxes in exchange for Motorola funneling the extra charges back to Charter for "advertising." J.A. 57a-58a, SAC ¶¶ 103, 105.

Again, there was no legitimate business purpose for this agreement. J.A. 53a, SAC ¶ 93; Respt. App. 32, AC ¶ 77. In December 1999, Charter secured a contract to purchase 1,000,000 set-top boxes from Motorola at fixed prices for the 24-month period covering 2000 to 2001. J.A. 53a, SAC ¶ 94. In early fall 2000, however, Charter agreed to purchase 540,000 units from Motorola in the four-month period from September 1, 2000 to December 31, 2000, paying an additional $20 per unit. J.A. 57a, SAC ¶ 103. The 540,000 units represented the total amount that Charter expected to purchase for all of 2001. J.A. 57a-58a, SAC ¶ 104.

This new agreement provided that Charter would pay Motorola the additional $20 per unit even if Charter decided not to purchase the set-top boxes. J.A. 57a-58a, SAC ¶¶ 103-104. This enabled Motorola to pay for the "advertising." *Id.*

Charter informed Respondents that in order to deceive Charter's accountants, they had to create the appearance that there was no relation between the set-top box price increase agreements and the advertising contracts. Indictment, *United States v. Barford*, No. 4:03 CR 00434 (E.D. Mo. July 24, 2003), at ¶ 23 (*available at* http://www.usdoj.gov/dag/cftf/chargingdocs/charterindictment.pdf);[2] *see also* J.A. 55a-56a, SAC ¶ 100. Therefore, there would have to be separate contracts covering the transactions. *Id.* Accordingly, simultaneously with the new agreements for the set-top boxes, Charter and each of the Respondents entered into agreements entitled "Spot Telecasting and Digital Marketing Support Fee Agreements." J.A. 58a, SAC ¶ 106. The amounts Respondents agreed to pay for the advertising were exactly equal to the overpayments that Charter made to Respondents: Motorola would pay $10,800,000 and Scientific-Atlanta $6,730,000. J.A. 56a, SAC ¶ 101.

Further underscoring the lack of legitimacy of the advertising agreements, Respondents agreed to pay rates that were four to five times more than Respondents customarily paid for similar advertising elsewhere. J.A. 58a, SAC ¶ 106. Respondents were unwilling to purchase advertising with their own money even at prevailing rates, and were willing to pay these inflated rates only because Charter was footing the bill. *Id.*

The contracts with Respondents for the set-top box price increases as well as the advertising were not finalized until late

---

2. The indictment is discussed in detail and incorporated by reference into the Second Amended Complaint. J.A. 59a-60a, 101a-02a, SAC ¶¶ 110, 194-95. Moreover, this Court can take judicial notice of the indictment and SEC litigation and administrative releases regarding the investigations alleged in the Second Amended Complaint because they are public records. *See Papsan v. Allain*, 478 U.S. 265, 269 (1986) (on review of a decision on a motion to dismiss, the Court is "not precluded from taking notice of items in the public record").

September 2000. J.A. 59a, SAC ¶ 107. Nonetheless, in order to create the false impression that the contracts were unrelated, Respondents agreed to, and executed, set-top box contracts backdated to August. J.A. 59a-60a, SAC ¶ 110.

As Respondents well understood, the sole purpose of their deceptive conduct was to further the scheme to overstate Charter's revenue and operating cash flow in financial statements which were filed with the SEC and issued to the investing public. J.A. 18a-19a, SAC ¶¶ 7, 10. When the true facts became known concerning these transactions, Charter's financials were restated to properly reflect economic reality (J.A. 98a, SAC ¶¶ 186-88; Respt. App. 66-67, AC ¶¶ 154-56), and the market price of its securities declined substantially. J.A. 94a-97a, SAC ¶¶ 178-79; Respt. App. 63-64, AC ¶¶ 146-47.

The district court dismissed the claims against Respondents, holding that they were not primary violators of § 10(b) and Rule 10b-5 as Petitioners had alleged, but rather were aiders and abettors of Charter in its violation of § 10(b). Accordingly, the district court held that the claims against Respondents were barred by this Court's holding in *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 191 (1994). Pet. App. 69a. The court also denied Petitioner's motion to amend the complaint to plead additional facts on the ground that it would be futile because the amendment was based on the same legal claim which the court found unsustainable. Pet. App. 28a.

The Court of Appeals affirmed the district court's dismissal of the claims, holding that the language of § 10(b) making it unlawful for "any person" to "use or employ" "directly or indirectly" "any . . . deceptive device or contrivance" in connection with the purchase or sale of securities was constricted by this Court's decision in *Central Bank* to prohibit "only the making of a misstatement or a failure to disclose by one who

has a duty to disclose." Pet. App. 5a.[3] The court concluded that absent such a statement or failure to disclose, Respondents' conduct amounted to that merely of aiders and abettors, and the claims against them were foreclosed by *Central Bank*. Pet. App. 10a.

In reaching this conclusion, the Court of Appeals erroneously characterized Respondents' arrangements with Charter as "arm's length business transactions." *Id.* The SEC and the DOJ viewed them differently, as should this Court.

An indictment brought by the United States Attorney for the Eastern District of Missouri against two of Charter's officials who devised the scheme alleged, *inter alia*, that there were "no real economic benefits to either of these suppliers or to Charter" because "Charter would be using its own funds to purchase the advertising from itself." Indictment, *United States v. Barford*, at ¶ 18.

As part of a plea agreement, one of these defendants stipulated that "[t]he purpose of this transaction was not to confer an economic benefit on these suppliers or on Charter, but rather to increase Charter's reported revenue and cash flow." *United States v. Barford*, SEC Litig. Release No. 19,240 (May 26, 2005).

Similarly, in an SEC Order Instituting Cease and Desist proceedings against Charter, the SEC made a finding that:

> In reality, no real revenue was generated from these transactions because Charter provided the suppliers

---

3. The Court of Appeals affirmed the district court's refusal to permit the filing of a Second Amended Complaint which sets out with substantial specificity Respondents' deceptive acts in furtherance of the scheme. The Court of Appeals noted that the "Complaint is factually detailed, as it must be to satisfy the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995." Pet. App. 3a. It held, however, that the amendments would be futile because they could not meet the limited reading of the statute under its decision. *Id.* at 11a.

> with the money they used to purchase the advertising services from Charter.

In re Charter Communications, Inc., SEC Exchange Act Release No. 50,098 (July 27, 2004) at ¶¶ 3, 13.

Further, the SEC found that the advertising contracts "were not undertaken at the fair value of the time slots purchased because these set-top box suppliers paid four to five times more for their advertisement time slots than other parties had paid Charter for advertisement time slots during 2000." *Id.* at ¶ 14.

At the time that Respondents were engaging in phony transactions with Charter, they were doing virtually the same thing with Adelphia Communications Corporation ("Adelphia"). *See* J.A. 60a, SAC ¶¶ 111-12 (Adelphia executive testified that its sham transactions were "Charter like"). In separate proceedings, the SEC obtained Cease and Desist Orders against Motorola and two executives of Scientific-Atlanta. *See In re Haislip*, SEC Exchange Act Release No. 54,030 (June 22, 2006); *In re Eidson*, SEC Exchange Act Release No. 54,031 (June 22, 2006); *In re Motorola, Inc.*, SEC Exchange Act Release No. 55,725 (May 8, 2007). As it noted in its complaint against Scientific-Atlanta, the SEC targeted these claims because they involved much larger sums of money. Complaint, *SEC v. Scientific-Atlanta, Inc.*, No. 06 Civ. 4823 (S.D.N.Y. June 22, 2006), at ¶¶ 35-36 (*available at* http://www.sec.gov/litigation/complaints/2006/comp19735.pdf); *see also* J.A. 60a, SAC ¶ 112. The SEC orders and complaint found that Respondents' transactions with Adelphia were shams and that it was obvious to Respondents that Adelphia would misuse the results of the transactions in financial reports.

Although these proceedings against Respondents concluded subsequent to the Eighth Circuit's decision, they are reflective of the views of an expert agency charged with the responsibility

of enforcing the securities laws that transactions like those at issue here are not legitimate arm's length transactions.[4]

Moreover, if the claims against Respondents had not been dismissed below, their conduct with Adelphia would have been probative of their scienter in their transactions with Charter.

SUMMARY OF ARGUMENT

Respondents' conduct was unlawful under the plain language of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Section 10(b) makes it unlawful for "any person, directly or indirectly" to "use or employ," in connection with the purchase or sale of securities, "any . . . deceptive device or contrivance" in violation of implementing SEC regulations.

It is impossible to see how Respondents' scheme with Charter can be described as anything other than a "deceptive device or contrivance." Respondents engaged in a series of sham transactions; they then falsified documents in order to conceal the true nature of those transactions. They did all this for the purpose of inflating the price that purchasers would be willing to pay for Charter's stock – thus acting "in connection with the purchase or sale" of securities. Respondents' conduct fits easily within the terms of Rule 10b-5 as well: they "employ[ed] a[] device, scheme or artifice to defraud" and they "engage[d] in" a number of "act[s]" and "practice[s]" that "operate[d] as a fraud or deceit."

There was no legitimate business purpose for these transactions, and none of them was "arm's length." Rather, they were artifices for Respondents to receive funds from Charter for them to funnel back to Charter. The "advertising" contracts called for Respondents to pay four to five times ordinary rates.

---

4. The Amended Complaint referenced the ongoing investigation of Scientific-Atlantic by the DOJ and the SEC. Respt. App. 34, AC ¶ 82. *See also* J.A. 60a, SAC ¶¶ 111-12.

And to assure that these deceptive arrangements would be reflected in Charter's financial statements, Respondents themselves falsified documents. The scheme had the intended purpose and effect.

While this Court has repeatedly stated that Section 10(b) and Rule 10b-5 should be read flexibly to give effect to Congress's intent that they serve a remedial purpose and "catchall" function, the facts of this case do not require an expansive reading of these provisions. Respondents' conduct violates the plain language of the statute and Rule under *any* natural reading.

The Court of Appeals rewrote the statute. Section 10(b) – conspicuously unlike other provisions of the securities laws – is not limited to "misstatements," a word that does not appear in the section. Congress instead chose the phrase "any ... deceptive device or contrivance." That inclusive phrase was obviously chosen to reach beyond verbal misrepresentations by covering conduct designed to convey false information. The breadth of the prohibition is again confirmed by Rule 10b-5, which reaches not just false statements (Rule 10b-5(b)) but "any device, scheme, or artifice to defraud" (Rule 10b-5(a)) and "any act, practice or course or business which operates or would operate as a fraud or deceit upon any person" (Rule 10b-5(c)).

The contrast between Section 10(b) and other provisions of the securities laws – which are expressly limited to misstatements – shows that Congress's choice of expansive words, going beyond "misstatements," was not inadvertent. In Section 11 of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77k, the same 73rd Congress that enacted § 10(b) limited liability to only a certain class of persons, only for misstatements and omissions and only for a registration statement filed with the SEC covering the issuance of securities. Section 12(a)(2) of the Securities Act, 15 U.S.C. § 77l(a)(2), is similarly worded.

Certainly, if Congress had intended to limit the reach of § 10(b) it would have included similar express restrictions. The Court made the point clearly in distinguishing between the narrow scope of § 11 and the broad contours of § 10(b) in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983).

The Court of Appeals sought to justify its conclusions by asserting that imposing "liability for securities fraud on one party to an arm's length business transaction in goods and services other than securities because that party knew or should have known that the other party would use the transactions to mislead investors in its stock would introduce potential far reaching duties and uncertainties" for such parties. Pet. App. 10a. The Court of Appeals, however, mischaracterized this case. This is not a case involving an "arm's length transaction" in which a party acted honestly but perhaps with knowledge that the transaction would be used to mislead investors. This is a case in which Respondents themselves engaged in fraud. Respondents engaged in transactions that they knew were shams, and Respondents then lied about those transactions. No "far reaching duties and uncertainties" will be introduced if the decision below is reversed; any party will be able to avoid liability by simply not engaging in its own deceptive conduct.

Respondents' deceptive acts had the purpose and effect of furthering the fraudulent scheme. Their active participation was material to its accomplishment and the consequences foreseeable. The results were published in Charter's financial statements with the expected result of inflating the price of its securities.

In *Central Bank*, the Court recognized that "[i]n any complex securities fraud, . . . there are likely to be multiple [primary] violators," and further recognized that "[t]he absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability." 511 U.S. at 191. *Central Bank* did not address whether a primary violation for a deceptive scheme or course of conduct

is proscribed for secondary actors under Rule 10b-5(a) or (c) since that issue was not before the Court. Rather, in *Central Bank*, the plaintiff conceded that the defendant had not committed any deceptive acts itself but had only facilitated a fraud perpetrated by others.

The scheme perpetrated on Charter's investors could not have been accomplished by Charter acting alone. It required willing participants – not bystanders merely allowing the fraud to occur or facilitating it by non-deceptive conduct, but partners who would perform their own deceptive acts to enable the scheme to achieve its intended purpose. Charter found those partners in Respondents, and they must not be "free from liability." 511 U.S. at 191.

Lawsuits on behalf of investors defrauded by such conduct pose no threat to legitimate business people. Sham transactions and fraudulent paper trails do not pass muster under any notion of how legitimate business is to be transacted. Not only do they result in financial losses – sometimes ruinous – for innocent investors, but they corrode and undermine the integrity of our markets, impede effective capital formation and negatively impact the economy. These are evils that § 10(b) was designed to prevent.

Legitimate business will be unaffected if the Court adopts a test giving effect to the plain text of Section 10(b) and Rule 10b-5, but going no further. One proposed test would be that: a person engages in a deceptive act as part of a scheme to defraud investors, and violates Section 10(b) and Rule 10b-5(a) and/or (c), if the purpose and effect of his conduct is to create a false appearance of material fact in furtherance of that scheme.

The Court of Appeals' circumscribed reading of § 10(b) is also inconsistent with the amendments to the Exchange Act enacted by Congress in the Private Securities Litigation Reform Act of 1995, Pub. L. 104-69, 109 Stat. 737 (Dec. 22, 1995) ("PSLRA"). In response to perceived abuses in securities fraud

class actions, Congress imposed a variety of conditions to the maintenance of such suits. However, it did nothing to limit the substantive prohibitions of the statute. Indeed, recognizing that there may be multiple actors in a securities fraud, Congress imposed a system that made each actor responsible only for its proportionate share of damages absent a knowing violation. Proportionate liability explicitly acknowledges that secondary actors may be liable as primary violators.

The PSLRA's tests for determining when to apply proportionate liability are instructive. Congress set forth one test related to conduct consisting of false and misleading statements, and one test related to other "conduct," reflecting the full range of "deceptive devices" prohibited by Section 10(b). *See* 15 U.S.C. § 78u-4(f)(10). Similarly, in the Securities Litigation Uniform Standards Act of 1998, Pub. L. 105-353, 112 Stat. 3227 (Nov. 3, 1998) ("SLUSA"), Congress reiterated its understanding that deceptive conduct involves more than just misstatements and omissions when it used those terms in the disjunctive. *See* 15 U.S.C. § 78bb(f)(5)(E).

Extensive Congressional hearings and debates preceded the enactment of the PSLRA and SLUSA. While the amendments to the securities laws protect against nonmeritorious suits and awards disproportionate to wrongdoing, Congress recognized the important role that meritorious suits play to protect the integrity of our markets. If a change is to be made to the substantive law, it should be made by legislative action. The Court of Appeals relegated this task to itself, and the decision should be reversed.

ARGUMENT

I. Schemes To Defraud Are Prohibited by the Plain Language of Section 10(b) and Rule 10b-5.

Congress enacted the Securities Exchange Act of 1934 to "'insure honest securities markets and thereby promote investor confidence' after the market crash of 1929." *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (quoting *United States v. O'Hagan*, 521 U.S. 642, 658 (1997)). Section 10(b) is a key provision of the 1934 Act, making it unlawful for "any person, directly or indirectly" to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance." 15 U.S.C. § 78j(b). Congress intended Section 10(b) to be a "catchall" provision to prevent the full range of "cunning devices" used to defraud investors. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 202-03 (1976). Although it has amended the Exchange Act several times since 1934, Congress has steadfastly refused to narrow the plain text of Section 10(b).

This Court has recognized the "important part" that Section 10(b) and Rule 10b-5 play in the "federal regulation of vital elements of our economy." *Merrill Lynch, Pierce, Fenner & Smith v. Dabit*, 126 S. Ct. 1503, 1509 (2006). "The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated." *Id.*

Despite the clear language and important purpose of Section 10(b) and Rule 10b-5, the Court of Appeals refused to apply the statute and rule as written. Instead, citing policy concerns, the court below imposed limitations that were never enacted by Congress or promulgated by the SEC, and that had no basis in the language of Section 10(b) or Rule 10b-5. Statutes must be interpreted as written, even if a court deems the policies adopted by Congress unwise or outdated: "'Whatever temptations the statesmanship of policy-making might wisely suggest,' the judge's job is to construe the statute – not to make it better."

Jones v. Bock, 127 S. Ct. 910, 921-22 (2007) (quoting Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 533 (1947)); *see also Central Bank*, 511 U.S. at 188 ("Policy considerations cannot override our interpretation of the text and structure of the Act, except to the extent that they may help to show that adherence to the text and structure would lead to a result 'so bizarre' that Congress could not have intended it.") (citation omitted).

A. Deceptive Devices and Contrivances Prohibited by the Plain Text of Section 10(b) Include Schemes to Defraud.

"'[T]he starting point in every case involving construction of a statute is the language itself.'" *Ernst & Ernst*, 425 U.S. at 197 (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975)). The Court has specifically emphasized "[a]dherence to the text in defining the conduct covered by § 10(b)." *Central Bank*, 511 U.S. at 174. The text of Section 10(b) prohibits "any . . . deceptive device or contrivance" by "any person, directly or indirectly." 15 U.S.C. § 78j(b). Because these words are unambiguous, "the judicial inquiry is complete." *Desert Palace, Inc. v. Costa*, 539 U.S. 90, 98 (2003) (citation and quotation omitted).

The Court of Appeals refused to give effect to the plain text enacted by Congress. Instead, it treated Section 10(b) as if it were limited to only direct misrepresentations or omissions. However, that is not how Congress drafted the statute. Section 10(b) does not even mention misrepresentations or omissions, let alone specify that its scope is limited to only those particular forms of deceptive conduct. As the Court noted in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983), the broad language of Section 10(b) contrasts markedly with other sections of the securities laws that are "limited in scope."

Congress's refusal explicitly to limit Section 10(b) to misrepresentations and omissions should not be cast aside

as a mere oversight. In *Central Bank*, this Court reasoned that if Congress had intended to include aiding and abetting liability in Section 10(b), it would have done so explicitly. 511 U.S. at 177. The same fidelity to statutory text should apply here.

Congress knew how to limit sections of the securities acts to misrepresentations and omissions when it chose to do so. In each section it intended to be restricted, Congress invoked a specific limiting phrase. *See* Securities Act §§ 10, 11, 12 and 17 and Exchange Act § 14(e) (all prohibiting the making of "any untrue statement of a material fact or [the omission of] any material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading"). Congress's decision to reject this language in Section 10(b) indicates that it did not intend Section 10(b) to be similarly restricted. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 n.5 (1989) (where Congress used a specific phrase to restrict the scope of bankruptcy code provisions, it would be "inconsistent" to similarly restrict provisions cast in broader terms).

The actual terms of Section 10(b) unquestionably reach those who defraud investors indirectly via a scheme. As this Court explained in *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971), "'§ 10 (b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws.'" *Id.* at 11 n.7 (quoting *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)) (emphasis in original).

Section 10(b) covers deceptive conduct by "any person," whether "directly or indirectly." 15 U.S.C. § 78j(b). Congress's use of the term "any" was "obviously meant to be inclusive." *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972). "Directly" means "without anything intervening; personally." *Webster's International Dictionary* 738 (2d ed.

1934). "Indirectly" means "not directly." *Id.* at 1267. Thus, all those who engage in deceptive conduct in connection with the purchase or sale of securities violate Section 10(b), even if the fraud is accomplished as part of a greater scheme.[5]

In *Ernst & Ernst v. Hochfelder*, the Court made clear that the words "device" and "contrivance" each incorporate schemes to defraud, as are at issue in this case. 425 U.S. at 199 n.20. Citing *Webster's International Dictionary* (2d ed. 1934), the Court defined "device" to mean "[t]hat which is devised, or formed by design; a contrivance; an invention; project; ***scheme; often, a scheme to deceive***; a stratagem; an artifice," and defined "contrivance" to mean "[a] thing contrived or used in contriving; a ***scheme, plan, or artifice***." *Id.* (emphasis added).[6]

While the Court has not expressly defined the adjective "deceptive" in the context of Section 10(b), it has indicated how that word should be construed. "[L]egislation when not expressed in technical terms is addressed to the common run of men and is therefore to be understood according to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him." *Id.*, 425 U.S. at 199 n.19 (citation and quotation omitted). Absent an indication that Congress intended the words of a statute to bear some different import,

---

5. Petitioner acknowledges that the term "directly or indirectly" does not reach those who did not themselves engage in a deceptive act, but merely aided or abetted a violation by another. Here, Respondents themselves are alleged to have engaged in deceptive practices. *Cf. Central Bank*, 511 U.S. at 176 (stating that "aiding and abetting liability extends beyond persons who engage, even indirectly, in a proscribed activity").

6. The terms "employ" and "use" also defy restriction. "Employ" is a synonym for the verb "use," *Webster's International Dictionary* 839 (2d ed. 1934), which means "to engage in" or "to put into operation," *id.* at 2806. Both verbs focus exclusively on the conduct of the violator and do not require any particular relationship with those injured by the conduct.

they should be given their "'ordinary, contemporary, common meaning.'" *Williams v. Taylor*, 529 U.S. 420, 431 (2000) (quoting *Walters v. Metro. Educ. Enters., Inc.*, 519 U.S. 202, 207 (1997)).

The "ordinary, contemporary, common meaning" of "deceptive" easily encompasses schemes to defraud and fraudulent business practices. The same dictionary used in *Ernst & Ernst* "defines 'deceptive' as '[t]ending to deceive; having power to mislead.'" *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 502 (S.D.N.Y. 2005). The scheme to defraud here, using sham transactions and false and backdated documents to cause the publication of artificially inflated financial statements to investors, falls squarely within this definition.[7]

Congress itself recognized that the term "deceptive conduct" embraced more than just misrepresentations and omissions in the PSLRA. It set forth two separate tests to define a "knowing violation" for purposes of determining proportionate liability, *one for misrepresentations and omissions, and one for other "conduct."*[8] Section 21D(f)(10), 15 U.S.C. § 78u-4(f)(10). Had Congress understood "deceptive devices" to be limited to just misrepresentations and omissions, it would not have included

---

7. The legal meaning of "deception" similarly includes Respondents' scheme to defraud. That term embraces all "intentional misleading by falsehood," whether "spoken or acted." *Black's Law Dictionary* 529 (3d ed. 1933).

8. Similarly, in SLUSA, Congress referred to misrepresentations and omissions in the disjunctive from other "deceptive conduct," 15 U.S.C. § 78bb(f)(5)(E), indicating that it intended to give each term separate meaning. *See Dole Food Co. v. Patrickson*, 538 U.S. 468, 476-77 (2003) (statutes should be construed, if possible, so that "every word has some operative effect") (citation and quotation omitted). Congress's use of "deceptive" in Section 10(b) should also be given independent meaning. *Dabit*, 126 S. Ct. at 1513 ("identical words used in different parts of the same statute are . . . presumed to have the same meaning") (citation and quotation omitted).

a test for other "conduct." The Act should be construed to give both tests meaning. *Dole Food*, 538 U.S. at 476-77.

Congress's decision to enact detailed proportionate liability provisions also indicates that it "clearly anticipated the continued liability of secondary defendants." Jill E. Fisch, *The Scope of Private Securities Litigation: In Search of Liablility Standards for Secondary Defendants*, 99 COLUM. L. REV. 1293, 1313 (June 1999). Such provisions are of "limited importance unless the general standard of liability holds collateral defendants responsible" for their own fraudulent conduct. *Id. See also* 15 U.S.C. § 78u-4.

The requirement that the deceptive device or contrivance be used or employed "in connection with" the purchase or sale of securities cannot limit the scope of Section 10(b) to direct misrepresentations or omissions. The Court has consistently adopted a broad reading of this language. *See Dabit*, 126 S. Ct. at 1509; *O'Hagan*, 521 U.S. at 658; *Zandford*, 535 U.S. at 819-22. In *Zandford*, the Court held that conduct is "in connection with" the purchase or sale of securities so long as the alleged fraud "coincided" with securities transactions. *Id.* at 819-20, 822.

The "in connection with" language is more than satisfied here. Respondents' conduct served only to conceal the fact that Respondents were taking money from Charter with one hand and handing the same funds back to Charter with the other, causing false financial statements to be published to investors and artificially lifting the price of Charter's stock. *See, e.g.*, J.A. 52a-61a, SAC ¶¶ 91-114. Thus, Respondents' deceptive conduct more than coincided with investors' purchases of Charter securities; it caused the purchases to be made at inflated prices. *See Zandford*, 535 U.S. at 820-22.

The Court of Appeals may have disagreed with the broad language employed by Congress in Section 10(b), or the remedies Congress selected to prevent litigation abuses, but it

was not free to substitute its own judgment for that of the legislature. *Jones v. Bock*, 127 S. Ct. at 921-22. Section 10(b) must be construed as written, and it undeniably embraces the scheme to defraud alleged in this case.

B. The Plain and Unambiguous Language of Rule 10b-5 Prohibits Schemes to Defraud.

Congress granted the Securities and Exchange Commission the authority to define the scope of prohibited activity within the confines of Section 10(b). *See* 15 U.S.C. § 78j(b) (prohibiting only those "deceptive devices or contrivances" that contravene SEC rules). In response, largely drawing from the language of Section 17(a) of the Securities Act, the SEC promulgated Rule 10b-5. *Blue Chip Stamps,* 421 U.S. at 766-68 (Blackmun, J., dissenting) (discussing regulatory history).

Rule 10b-5 is broadly worded to implement all of the authority granted to the SEC in Section 10(b). *See Zandford,* 535 U.S. at 816 n.1 ("The scope of Rule 10b-5 is coextensive with the coverage of § 10(b) . . ."). Rule 10b-5 proscribes three distinct categories of fraudulent conduct: (a) devices, schemes and artifices to defraud; (b) misrepresentations and omissions of material fact; and (c) acts, practices, and courses of business which operate as a fraud or deceit. 17 C.F.R. § 240.10b-5.

For several decades, this Court has recognized a private cause of action under Rule 10b-5 and Section 10(b). "The existence of this implied remedy is simply beyond peradventure." *Huddleston*, 459 U.S. at 380. The implied remedy "has become an essential component of the protection the law gives to investors who have been injured by unlawful practices." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 374 (1991) (Kennedy, J., dissenting). Congress ratified the implied remedy when it enacted the PSLRA, maintaining the cause of action but providing several procedural hurdles to prevent abusive litigation. *See Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1340 (11th Cir.), *cert.*

denied, 537 U.S. 950 (2002) (noting that Congress enacted the PSLRA mainly to address private §10(b) claims).

The SEC has consistently maintained that its Rule and Section 10(b) "include conduct beyond the making of false statements or misleading omissions, for facts can be misrepresented by action as well as words." Amicus Curiae Brief of the SEC filed Oct. 22, 2004 in *Simpson v. AOL Time Warner, Inc. (Calif. St. Teachers Ret. Sys. v. Homestore.com, Inc.)*, No. 04-55665 (9th Cir.), at 8.[9] The Commission correctly noted that a business partner "achieve[s] the same deception" by creating a false appearance of fact that becomes included in financial statements as it would by making a direct misrepresentation to shareholders. *Id.* Therefore, it has maintained that "liability should be equally available" against such parties. *Id.* The Commission's reasonable interpretation is consistent with the language of Section 10(b) and Rule 10b-5, and should be given deference. *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.16 (1988).

The Court of Appeals ignored the clear language of Rule 10b-5 and the SEC's reasonable interpretation thereof. Instead, it held that only the misrepresentations and omissions described in Rule 10b-5(b) were proscribed by the statute, effectively nullifying Rule 10b-5(a) and (c). *See* Pet. App. at 9a ("any defendant who does not make or cause to be made a fraudulent misstatement or omission . . . cannot be held liable under §10(b) or any subpart of Rule 10b-5."). The court below gave no reason for reading out of existence two thirds of Rule 10b-5.

The Eighth Circuit's judicial revision of Rule 10b-5 flies in the face of recent Congressional action. Congress has not only refused to limit Rule 10b-5 as the Court of Appeals did, but has expressly extended Rule 10b-5, including all subparts.

---

9. The Department of Justice took the same position in *O'Hagan*. *See* Reply Brief of the United States, 1997 U.S. S. Ct. Briefs LEXIS 144, at *7 (April 9, 1997) ("a course of conduct that is fraudulent is also deceptive, for the concept of fraud inherently includes deception.").

In 2000, Congress amended Section 10(b) to provide that the prohibitions of Rule 10b-5 apply to securities-based swap contracts, as well as purchases and sales of securities. Pub. L. 106-554, 114 Stat. 2763 (Dec. 21, 2000). By extending Rule 10b-5, Congress indicated its approval of the rule as promulgated.

This Court's precedent also prohibits the appellate court's rewriting of Rule 10b-5. In *United States v. Naftalin*, 441 U.S. 768 (1979), the Court examined the virtually identical language of Section 17(a) of the Securities Act, upon which Rule 10b-5 was based. It held that all three parts should be given independent effect, rejecting the argument that the limitations of one subsection should be read as limiting other subsections. *Id.* at 773. Noting that "Congress did not write the statute that way," the Court explained:

> As is indicated by the use of an infinitive to introduce each of the three subsections, and the use of the conjunction "or" at the end of the first two, each subsection proscribes a distinct category of misconduct. n5 Each succeeding prohibition is meant to cover additional kinds of illegalities – not to narrow the reach of the prior sections. *See United States v. Birrell*, 266 F. Supp. 539, 542-543 (S.D.N.Y. 1967). There is, therefore, "no warrant for narrowing alternative provisions which the legislature has adopted with the purpose of affording added safeguards." *United States v. Gilliland*, 312 U.S. 86, 93 (1941).
>
> * * * *
>
> n5 Moreover, while matters like "punctuation [are] not decisive of the construction of a statute," *Costanzo v. Tillinghast*, 287 U.S. 341, 344 (1932), where they reaffirm conclusions drawn from the words themselves they provide useful confirmation.

> Here the use of separate numbers to introduce each subsection, and the fact that the phrase "upon the purchaser" was set off solely as part of subsection (3), confirm our conclusion that "[nothing] on the face of the statute suggests a congressional intent to limit its coverage," *United States v. Culbert*, 435 U.S. 371, 373 (1978), to frauds against purchasers.

Id. at 774-75. The identical structure and virtually identical language employed in Rule 10b-5 require that each of its three subparts also be given independent meaning. *Id.*

II. The Court of Appeals Misread *Central Bank* and Ignored This Court's Subsequent Explanation.

The court below relied heavily on this Court's decision in *Central Bank*. But it is easy to see why this case is, at the most fundamental level, different from *Central Bank*: in this case, unlike *Central Bank*, the Respondents engaged in fraud. Respondents did not just facilitate or aid and abet Charter's fraud; they engaged in classic fraudulent behavior themselves. They participated in transactions that they knew to be shams, and they falsified records about those transactions. Respondents did this for the purpose and effect of corrupting the flow of information to investors. This is just the kind of conduct that the language of Section 10(b) and Rule 10b-5 forbids. Far from supporting Respondents, *Central Bank* – a decision based on scrupulous adherence to the language of Section 10(b) – is deeply inconsistent with Respondents' arguments.

From the very first line of *Central Bank*, this Court recognized that primary liability under Section 10(b) is not limited to just misrepresentations or omissions, but rather includes any "manipulative or deceptive act in connection with the purchase or sale of securities." 511 U.S. at 166. The Court of Appeals failed to consider whether the forged documents, false paper trail, and sham transactions generated by Respondents constituted "deceptive acts." Instead, focusing on

the following *dicta* from *Central Bank*, the Eighth Circuit concluded that *Central Bank* was intended to judicially restrict the plain text of Section 10(b):

> The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met.

Pet. App. 6a (quoting *Central Bank*, 511 U.S. at 191).

While the Court of Appeals described the instant case as one that "tested the boundaries" of the "caveat" it quoted from *Central Bank*, it ignored the Court's direction in a subsequent decision, *O'Hagan*, not to draw undue conclusions from this very text. *Id.* In *O'Hagan*, this Court explained:

> The Eighth Circuit isolated the statement just quoted and drew from it the conclusion that § 10(b) covers only deceptive statements or omissions on which purchasers and sellers, and perhaps other market participants, rely. *See* 92 F.3d at 619. It is evident from the question presented in *Central Bank*, however, that *this Court, in the quoted passage, sought only to clarify that secondary actors, although not subject to aiding and abetting liability, remain subject to primary liability under § 10(b) and Rule 10b-5 for certain conduct.*

521 U.S. at 664 (emphasis added).

The Eighth Circuit repeated its error in the decision below. It focused on the same *dicta* that this Court had already directed it not to view in isolation, as well as similar *dicta* stating that "the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act." *Central Bank*, 511 U.S. at 177. Based on this *dicta*, and contrary to the Court's explanation elsewhere in *Central Bank* and again in *O'Hagan*, the Court of Appeals erroneously held that *Central Bank* was intended to narrow the plain language defining primary liability in Section 10(b) and Rule 10b-5. Pet. App. 5a-9a. As a result, it held that Respondents, who did not themselves make misrepresentations or omissions to investors, could be no more than aiders and abettors. *Id.*

The Eighth Circuit also ignored the critical factual differences between *Central Bank* and this case. *Central Bank* involved an indenture trustee who did not enter into sham transactions, did not falsify or backdate any contracts, did not engage in any misrepresentations, and did not itself create any false appearance of material fact. *First Interstate Bank, N.A. v. Pring*, 969 F.2d 891, 902-03 (10th Cir. 1992), *rev'd on other grounds sub nom. Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S.164 (1994). Nor did the trustee owe any duties to the plaintiffs in that case, who purchased bonds pursuant to a 1988 bond offering. While the plaintiffs contended that the indenture trustee could have required an independent audit under a separate 1986 bond offering that may have uncovered the fraud, the Indenture Trust Act of 1939 strictly limited the obligations of indenture trustees to those set forth in the indenture. Thus, no duty could have run to those plaintiffs based on the separate 1986 indenture. *First Interstate*, 969 F.2d at 903.

As this Court emphasized, the *Central Bank* plaintiffs "concede[d] that Central Bank did not commit a manipulative or deceptive act within the meaning of § 10(b)." 511 U.S. at 191. Instead, they claimed that the bank violated Section 10(b) without committing a deceptive act by recklessly aiding and

abetting the violation of another defendant. The plaintiffs in *Central Bank* argued that the indenture trustee provided "substantial assistance" by delaying the independent audit it was authorized but not required to undertake, supporting secondary liability. The question presented to this Court was whether "private civil liability under §10(b) extends . . . to those who do not engage in the manipulative or deceptive practice, but who aid and abet the violation." 511 U.S. at 167.

The facts presented in this case involve the exact opposite issue – whether Respondents should be liable under Section 10(b) ***for their own deceptive practices***. Petitioner has alleged in detail false documents prepared by *Respondents*, contracts backdated by *Respondents*, and sham transactions *Respondents* entered into with Charter, all of which created the false appearances of material fact that inflated Charter's published financial statements. Thus, unlike in *Central Bank*, Petitioner does not seek to "extend" civil liability under Section 10(b). Rather, it asks this Court to enforce Section 10(b) as written, prohibiting deceptive acts by "any person, directly or indirectly."

III. This Court Has Consistently Recognized That Schemes to Defraud Are Unlawful Under the Text of Section 10(b) and Rule 10b-5.

The decision below contradicts a long line of decisions of this Court both before and after *Central Bank* applying the broad text of Section 10(b) and Rule 10b-5. The Court has repeatedly stated that "securities legislation enacted for the purpose of avoiding frauds be construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.'" *Ernst & Ernst*, 425 U.S. at 217 (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)); *see also Bankers Life*, 404 U.S. at 12 (1971) (same); *Affiliated Ute*, 406 U.S. at 151 (same); *Huddleston*, 459 U.S. at 386-87 (same); *Central Bank*, 511 U.S. at 198 (same); *Zandford*, 553 U.S. at 819 (same).

In *Bankers Life*, the Court emphasized that "§ 10(b) bars the use of any deceptive device in the 'sale' of any security by 'any person.'" *Id.*, 404 U.S. at 10. Thus, it allowed an insurer defrauded in connection with the sale of its bond holdings to proceed with claims under § 10(b) and Rule 10b-5 against both the insider who sold the bonds and the "outside collaborators" who created the paperwork allowing him to misappropriate the proceeds. *Id. See also Central Bank*, 511 U.S. at 191 (recognizing that "there are likely to be multiple violators" in "any complex securities fraud.").

The Court has also repeatedly explained that Section 10(b) and Rule 10b-5 extend beyond misrepresentations and omissions. In *Affiliated Ute*, it stated that although "the second subparagraph of [Rule 10b-5] specifies the making of an untrue statement of a material fact and the omission to state a material fact," the "first and third subparagraphs are not so restricted." 406 U.S. at 152-53. *See also Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 471 (1977) (listing "deception, misrepresentation, or nondisclosure" in the disjunctive, indicating that deception has some separate meaning); *accord Parmalat Sec. Litig.*, 376 F. Supp. 2d at 499; *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 335-36 (S.D.N.Y. 2004).

In *Huddleston*, the Court confirmed that primary liability under Section 10(b) and Rule 10b-5 encompasses persons who caused misrepresentations to be made to investors, as well as those who actually made the misrepresentations. 459 U.S. at 387 n.22. Expressly limiting its opinion to primary liability, not aiding and abetting, *see id.* at 379 n.5, the Court explained that Section 10(b) "extends to 'any person' who engages in fraud in connection with a purchase or sale of securities," even where the statements ultimately conveyed to shareholders are not attributed to that person. *Id.* at 387 n.22.

Following *Central Bank*, this Court made clear that private claims may be brought for schemes to defraud as well as misrepresentations and omissions. *Wharf (Holdings) Ltd. v.*

United Int'l Holdings, Inc., 532 U.S. 588 (2001). Justice Breyer, writing for a unanimous Court, explained that:

> [R]ule [10b-5] forbids the use, "in connection with the purchase or sale of any security," of (1) "any device, scheme, or artifice to defraud"; (2) "any untrue statement of a material fact"; (3) the omission of "a material fact necessary in order to make the statements made . . . not misleading"; or (4) any other "act, practice, or course of business" that "operates . . . as a fraud or deceit." 17 CFR § 240.10b-5 (2000).
>
> *To succeed in a Rule 10b-5 suit, a private plaintiff must show that the defendant used, in connection with the purchase or sale of a security, one of the four kinds of manipulative or deceptive devices to which the Rule refers,* and must also satisfy certain other requirements not at issue here.

Id. at 593 (emphasis added); *see also id.* at 594 (referring to "other conduct forbidden by the Rule" besides misrepresentations).

In *Zandford,* the Court reinforced the principle that Section 10(b) and Rule 10b-5(a) could be violated by conduct alone. *Id.*, 553 U.S. at 821. Upholding summary judgment against a broker for a scheme to defraud his customer in connection with sales of the customer's securities, the Court explained that "each time respondent 'exercised his power of disposition for his own benefit,' that conduct, 'without more,' was a fraud." *Id.* (citation and quotation omitted).

These decisions, which shaped the interpretation of § 10(b) and Rule 10b-5 over the course of decades, were largely ignored by the court below. When considered as a whole, this body of law confirms what this Court explicitly stated in *O'Hagan*: that *Central Bank* was not intended to limit the scope of primary liability for those who commit deceptive acts. The Court of Appeals erred in holding otherwise.

IV. Giving Natural Meaning to the Language of Section 10(b) and Rule 10b-5 Would Not Affect Legitimate Business.

The Court of Appeals expressed concern that imposing liability for securities fraud on parties to arm's length business transactions would introduce potential far-reaching duties and uncertainties. Pet. App. 10a. That proposition may be correct, but it is not implicated here. This case involves transactions which were anything but arm's length, and were far outside standard business norms.

Lying, forging documents, and creating false paper trails are not "uncertain" business practices that fall into a judicial gray area. Congress has determined that such deceptive acts, when committed in connection with the purchase or sale of securities, may be criminal. 15 U.S.C. § 78j(b).[10] Thus, Congress has left no doubt that participating in a fraudulent scheme is unlawful, and those who do so notwithstanding the criminal nature of their conduct should understand that compensation may be available to their victims.

The Eighth Circuit was required to adhere to the text of Section 10(b) even if it felt its broad scope was unwise. *Central Bank*, 511 U.S. at 188; *Jones v. Bock*, 127 S. Ct. at 921-22. The proper course of action was not to imply limitations rejected by Congress, but to craft an appropriate test consistent with the statutory language, reaching the conduct proscribed by Congress but going no further. One proposed test would provide that:

> *A person engages in a deceptive act as part of a scheme to defraud investors, and violates Section 10(b) and Rule 10b-5(a) and/or (c), if the purpose and effect of his conduct is to create a false appearance of material fact in furtherance of that scheme.*

---

10. In many cases, these same acts will also constitute mail fraud in contravention of 18 U.S.C. § 1341 or wire fraud in contravention of 18 U.S.C. § 1343.

Any test adopted by the Court would be bolstered by the heightened pleading standards Congress imposed in the PSLRA. A plaintiff would be required to allege in detail not only the existence of a scheme to defraud, and each defendant's own deceptive conduct as part of that scheme, but also would need to plead specific facts giving rise to a strong inference of scienter. 15 U.S.C. § 78u-4(b)(2). Absent such a showing, defendants would not even be subject to discovery. 15 U.S.C. § 78u-4(b)(3). These pleading standards will protect against dubious suits as Congress intended. Legitimate business partners will be unaffected – only those who engage in their own deceptive conduct will face liability.

By focusing on the defendant's own deceptive conduct, the proposed test provides clear guidelines for business people. Those who themselves lie, forge documents or otherwise create false appearances of fact may face liability. Those who merely assist a scheme to defraud but do not commit their own fraudulent acts will, at most, be aiders and abettors, and will not face private liability.

Lower courts have demonstrated their ability to draw this distinction. In *Parmalat*, the district court sustained claims against defendants who created a false appearance of fact through sham factoring arrangements and the creation of misleading securitizations, but dismissed claims against banks that provided funding through various equity arrangements the plaintiff alleged supported the scheme to defraud, but where the banks did not themselves "use or employ a deceptive device or contrivance." 376 F. Supp. 2d at 504-05. In *Simpson*, after properly recognizing that Section 10(b) includes scheme liability, the Ninth Circuit affirmed dismissal of claims against business partners because the complaint failed to sufficiently allege that the business partners engaged in their own fraudulent conduct. *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040, 1052-55 (9th Cir. 2006), *petition for cert. filed sub nom. Calif. St. Teachers Ret. Sys. v. Homestore.com, Inc.*, 75 U.S.L.W. 3236 (U.S. Oct. 19, 2006) (No. 06-560).

The proposed test does not expose secondary actors to excessive liability. In the PSLRA, Congress enacted detailed proportionate liability provisions to ensure that a defendant is responsible only for its fair share of any damage award absent a knowing violation. *See* 15 U.S.C. § 78u-4. Accordingly, while raising the specter of vast liability may serve Respondents' strategic interests in this appeal, such fears are unfounded and cannot justify deviating from the clear language of Section 10(b) and Rule 10b-5.

V. Undermining the Plain Language of Section 10(b) and Rule 10b-5 Would Harm Markets and Create a Blueprint for Fraud.

Eliminating recourse against those who engage in schemes to defraud investors would undermine investor confidence and create a moral hazard encouraging fraud. Academic studies have determined that U.S.-listed companies enjoy substantial economic benefits because of the great trust investors place in our regulatory scheme. They are afforded richer valuations than their foreign-listed peers,[11] and have a significantly lower cost of capital.[12] Exposing investors to schemes to defraud would endanger confidence and imperil those savings.

Congress has recognized that private securities litigation is "an indispensable tool," helping to "promote public and global confidence in our capital markets" by helping to deter wrongdoing. Conference Report on Securities Litigation Reform, H.R. Rep. No. 104-369, 1995 U.S.C.C.A.N. 730 (Nov.

---

11. Craig Doidge, G Andrew Karolyi, and Rene M. Stulz, *Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time*, (Apr. 2007) (*available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=982193).

12. Charles D. Niemeier, *American Competitiveness in International Capital Markets* (Public Company Accounting Oversight Board, Sept. 30, 2006) (*available at* http://www.pcaobus.org/News_and_Events/Events/2006/Speech/09-30_Niemeier.aspx).

28, 1995). Similarly, the Court has repeatedly stated that private securities actions "provide 'a most effective weapon in the enforcement' of the securities laws and are a 'a necessary supplement to Commission action.'" *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)); *see also Lampf, Pleva*, 501 U.S. at 376 (Kennedy, J., dissenting) (quoting *Basic* for the proposition that "private § 10(b) suits constitute 'an essential tool for enforcement of the 1934 Act's requirements'").[13]

For these reasons, in 1995 and again in 1998, Congress chose to address potential nonmeritorious securities actions entirely through a series of procedural reforms as well as limitations on joint and several liability. It elected to maintain the broad text of Section 10(b).

The decision below, in addition to rewriting the statute, creates a moral hazard that is deleterious to investors. If the decision stands, companies will quickly learn that they can get away with fraud by compartmentalizing the creation of a false appearance of material fact from the ultimate reporting of false information to investors. If senior management keeps themselves sufficiently removed from the details of the scheme, relying on their lieutenants to "outsource" the fraudulent acts, neither the issuer nor the business partners creating the false documentation would face private liability. The issuer would claim that its senior management had no specific knowledge of the fraud and therefore lacked scienter, and the business partners that created the false appearance that distorted the published financial

---

13. Private actions are particularly important where, as here, defendants' conduct deceives independent public accountants performing an SEC-mandated audit and causes false financial statements to be issued. "[T]he independent auditor assumes a public responsibility" to investors when performing an outside audit and investor confidence depends upon the ability of investors to trust financial statements. *United States v. Arthur Young & Co.*, 465 U.S. 805, 819 n.15 (1984).

statements would simply point to the Eighth Circuit's test and argue that they are beyond the reach of the law.

Without fear of private liability, business partners would have an incentive to provide false documents and records as a service for important customers. For example, a logistics company could hide inventory for customers during audits, then create a false paper trail to ensure that inflated figures make their way into the customers' financial statements. An outside lawyer could forge executive option grants to hide backdating. A testing lab could, for a fee, provide false "proof" that a new invention worked or that a new drug was effective or safe. The logistics company, lawyer, or testing lab that created the false appearance of fact could then claim – as Respondents do here – that they themselves did not make statements to the investing public and therefore are beyond the scope of Section 10(b).

Investors should not be exposed to this threat because an activist court refuses to give plain meaning to the language enacted by Congress.

VI. Respondents' Deceptive Conduct Was a Primary Violation of Section 10(b) and Rules 10b-5(a) and (c).

A. Petitioner Has Alleged Deceptive Conduct and Scienter by Respondents Themselves.

Respondents are parties to this litigation because they engaged in their own fraudulent acts in furtherance of the scheme to defraud Charter investors. Respondents backdated documents to make it appear as if the contracts calling for increases in prices paid for set-top boxes were unrelated to the *quid pro quo* "advertising" agreements they used to funnel Charter's own money back to it as disguised "revenues." J.A. 59a-60a, SAC ¶ 110. Respondents created false documents to give the illusion that the price increases were caused by increased material costs. J.A. 53a, 55a-57a, SAC ¶¶ 93, 100-02. Respondents entered into contracts misrepresenting their

payments to Charter as "advertising," when in fact they were reciprocal payoffs made at five times standard advertising rates. J.A. 61a, SAC ¶ 114. And Respondents knew or recklessly disregarded that the sole purpose of these fraudulent acts was to artificially inflate Charter's published financial statements. J.A. 19a, 55a, SAC ¶¶ 10, 98-99.

Respondents' conduct mirrors that admitted by two Charter executives who were sentenced to over a year in prison for the mail and wire fraud they perpetrated in connection with this scheme. *See United States v. Barford*, SEC Litig. Release No. 19,240 (May 26, 2005). While those executives are no longer part of the investor lawsuit because their claims were settled, it is inconceivable that a court would give them civil immunity. Respondents' deceptive conduct should likewise not be exonerated.

Respondents also engaged in similar forgeries and lies as part of virtually identical sham transactions with another cable provider, Adelphia Communications. *See In re Eidson*, SEC Exchange Act Release No. 54,031 (June 22, 2006); *In re Haislip*, SEC Exchange Act Release No. 54,030 (June 22, 2006); *In re Motorola, Inc.*, SEC Exchange Act Release No. 55,725 (May 8, 2007). As in this case, Respondents backdated their contracts with Adelphia, lied about the reason for price increases, and misrepresented the true "wash" nature of the transactions. *See, e.g., In re Motorola* at ¶ 12. Respondents' repetition of the same deceptive acts confirms that their fraud was knowing and intentional.

B. Investors' Losses Were Causally Connected to the Scheme – Reliance Is Established.

The reliance requirement to maintain a damage suit under § 10(b) is easily satisfied in this case. Reliance, also referred to as transaction causation, provides the requisite causal connection between defendants' fraudulent conduct and plaintiff's injury. *Basic*, 485 U.S. at 243. There is "more than one way to

demonstrate the causal connection." *Id.* It can be established indirectly, and in many cases, presumed. *Id.* (finding that investors who rely on the integrity of an efficient market into which a misrepresentation is disseminated are presumed to have relied indirectly on the misrepresentation).[14] Here, the scheme in which Respondents engaged had the purpose and effect of artificially increasing Charter's revenue and cash flow reflected in Charter's financial statements. Those financial statements caused the price of Charter's stock to be inflated and the purchasers of the stock were accordingly damaged.

Although Respondents did not themselves disseminate the false information to the securities market, "[t]he scheme to defraud would not be complete until the fraudulent information has entered the securities market." *Simpson*, 452 F.3d at 1051.

In complex securities frauds, usually the corporate entity issues the false document in question. But sometimes, as here, the falsity of the document is built upon deceptive acts by secondary actors. Audited financial statements cannot be falsified by merely changing numbers. Inflating audited financial statements requires falsification of supporting documents such as contracts, invoices, shipping orders, and receipts. Those creating the false documents must not be allowed to escape liability by ignoring the role their own deceptive acts played in causing the issuance of the false financial statements that deceived investors.

Imposing private liability when the defendant's own wrongful conduct has been established is not in any way novel or expansive. Businesses have long been responsible for the

---

14. The fraud-on-the-market theory applies to claims under Rule 10b-5(a) and (c), as well as direct misrepresentation claims brought under Rule 10b-5(b). *See Simpson*, 452 F.3d at 1051. The securities market for the trading of Charter's stock is alleged to be efficient and well developed. J.A. 28a-29a, SAC ¶ 96; Respt. App. 72-73, AC ¶ 72.

foreseeable consequences of their own improper conduct. *See, e.g., Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 174 (2d Cir.), *cert. denied*, 546 U.S. 935 (2005); *accord Palsgraf v. Long Island R.R. Co.*, 162 N.E. 99 (N.Y. 1928).

Consistent with these principles, the Ninth Circuit has held that in Rule 10b-5(a) and (c) cases, investors "may be presumed to have relied on [a] scheme to defraud if a misrepresentation, which necessarily resulted from the scheme and the defendant's conduct therein, was disseminated into an efficient market and was reflected in the market price." *Simpson*, 452 F.3d at 1052. The same analysis was followed in *Parmalat*, where the Southern District of New York explained that:

> The banks made no relevant misrepresentations to those markets, but they knew that the very purpose of certain of their transactions was to allow Parmalat to make such misrepresentations. In these circumstances, both the banks and Parmalat are alleged causes of the losses in question.

376 F. Supp. 2d at 509. Where the deception is "a natural consequence of" or "necessarily resulted from" the defendant's own deceptive acts, "but for" causation is established, "even if a material misstatement by another person creates the nexus between the scheme and the securities market." *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 173 (D. Mass. 2003).

The SEC has agreed that reliance is not dependent upon direct misrepresentations from a particular defendant to investors. In *Simpson,* it took the position that a "prior deceptive act, from which the making of the false statements follows as a natural consequence, can constitute a sufficient step in the causal chain to support a finding of reliance." Amicus Curiae Brief of SEC in *Simpson* at 22.

Recognizing that deceptive acts can indirectly induce reliance is consistent with the language of Section 10(b) and

Rule 10b-5, both of which prohibit persons from indirectly employing deceptive acts. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Moreover, it reflects the fact that investors can be misled by both words and conduct. As the SEC explained, "if two companies together make a false statement about the revenues of one of them, both companies could be primarily liable for securities fraud. If they together achieve the same deception through conduct rather than words, the same result should obtain." Amicus Curiae Brief of SEC in *Simpson* at 19.

Here, Petitioner has alleged that Charter could not have succeeded in publishing the false financial statements that injured investors "but for" the deceptive acts of Respondents. Without the paper trail Respondents fabricated, Charter never would have had a purported basis for the inflated numbers it published to investors, and Charter's auditors never would have acquiesced to the publication of those numbers. J.A. 19a, 53a, SAC ¶¶ 8, 93 (alleging that the transactions were "absolute shams designed solely to give Charter the appearance of increased cash flows" and "increased revenues"); J.A. 19a, SAC ¶ 10 (alleging that Respondents knew that the transactions "were structured to inflate Charter's reported cash flows to investors, and thereby increase Charter's stock price"); J.A. 55a-56a, SAC ¶ 100 (alleging that if the timing and linkage of the set-top box and advertising contracts were honestly disclosed, "the accountants would treat the transactions as a wash").

Indeed, the false documents created by Respondents served no purpose other than to assure that the sham transactions were reflected in Charter's financials. J.A. 53a, SAC ¶ 93. Thus, the false representations Charter made in its financial statements necessarily resulted from and were the natural consequence of Respondents' own deceptive conduct, constituting "a sufficient step in the causal chain to support a finding of reliance." Amicus Curiae Brief of SEC in *Simpson* at 22. *See also Simpson*, 452 F.3d at 1052.

C. Petitioner Should Have Been Granted Leave To Replead.

Because the Court of Appeals applied the wrong legal standard concerning the scope of Section 10(b) and Rule 10b-5, it also held that any amendment by Petitioner would be futile. Pet. App. 11a. Consequently, it affirmed the district court's order denying leave to file the proposed Second Amended Complaint. Where pleading deficiencies appear futile only because the court has applied the wrong legal standard, the plaintiff should be afforded the opportunity to cure pleading defects in an amended complaint. *See United States v. Baxter Int'l, Inc.*, 345 F.3d 866, 903 n.33 (11th Cir. 2003) ("Because we reverse the district court's legal determination as to the viability of the Government's case, the district court's reason for denying leave to amend is no longer valid and that denial is accordingly vacated.").

Leave to amend is especially appropriate here. The amended complaint was the first dismissed by any court, and promptly thereafter Petitioner proffered the Second Amended Complaint curing the identified deficiencies.

CONCLUSION

Congress crafted a statute prohibiting deceptive practices in the purchase or sale of securities and gave authority to the SEC to implement its purposes "in the public interests or for the protection of investors." The SEC has promulgated such rules and Respondents' conduct was clearly in violation thereof. Respondents must not "be free from liability." *Central Bank*, 511 U.S. at 191. For the foregoing reasons, the decision of the Eighth Circuit should be reversed.

Respectfully submitted,

STANLEY M. GROSSMAN
Counsel of Record
MARC I. GROSS
JOSHUA B. SILVERMAN
POMERANTZ HAUDEK BLOCK
GROSSMAN & GROSS LLP
100 Park Avenue
26th Floor
New York, NY 10017
(212) 661-1100

Attorneys for Petitioner